



Regulatory Recognition: A Sign of a Maturing Digital Landscape?

Zoom Webinar

28 July 2020 | 4:00pm - 5:00pm



Digital Assets – Regulatory Recognition in Malaysia and Labuan

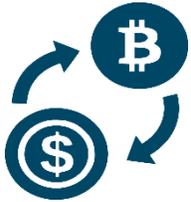
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Director, ZICO Trust Labuan

28 July 2020

The logo for ASEAN INSIDERS consists of a large, abstract shape composed of many small, light blue dots, resembling a stylized map of Southeast Asia. A single yellow dot is positioned at the bottom right of this shape.

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● Malaysia and Labuan – current regulations



- Malaysia – Capital Markets and Services Act 2007
- Capital Markets and Services (Prescription of Securities) (Digital Currency and Digital Token) Order 2019 (Effective 15 Jan 2020)
- Securities Commission Guidelines on Digital Assets (15 Jan 2020)
- Securities Commission Guidelines on Recognised Markets (5 May 2020)
- Labuan Financial Services and Securities Act 2010
- Labuan Circular on Innovative Financial Services (**IFS**) in Labuan IBFC (26 June 2018)

● Malaysia - Capital Markets and Services (Prescription of Securities) (Digital Currency and Digital Token) Order 2019



- Came into force on 15 January 2019, falls under the purview of Securities Commission Malaysia.
- Prescribes **digital currency** and **digital token** as “securities”. As securities, will be subject to provisions under the Capital Markets and Services Act 2007 except for Division 3 (Prospectus) of Part VI (Issues of Securities and Takeovers and Mergers) which relates to prospectus obligations on offers and issues of securities.
- Such securities that are offered or traded on or through a recognised market is not:
 - a share in or debenture of a body corporate or unincorporated body; or
 - a unit in a unit trust scheme or prescribed investment scheme.
- Does not overwrite Bank Negara (Malaysia’s Central Bank)’s policy on digital currencies - digital currencies are not recognised as money, and digital currency exchanges (operating platforms where digital currency transactions happen) are subject to reporting obligations to Bank Negara.
- Possibility that certain digital currencies and digital tokens may not be “prescribed securities” if they do not contain the features in the definitions of the Order.

● Capital Markets and Services (Prescription of Securities) (Digital Currency and Digital Token) Order 2019

Digital Currency

“digital representation of value which is recorded on a distributed ledger whether cryptographically-secured or otherwise, that functions as a medium of exchange and is interchangeable with any money, including the crediting or debiting of an account”

- Traded in a place or facility where offers to sell, purchase or exchange of, the digital currency are regularly made or accepted;
- An owner of the digital currency expects a return in any form from the trading, conversion or redemption of the digital currency or the appreciation in the value of the digital currency; **and**
- Not issued or guaranteed by any government body or central banks as may be specified by the Securities Commission.

Digital Token

“digital representation which is recorded on a distributed digital ledger whether cryptographically-secured or otherwise”

- Represents a right or interest of a person in any arrangement made for the purpose of, or having the effect of, providing facilities for the person where:
- the person receives the digital token in exchange for a consideration;
 - the consideration or contribution from the person, and the income or returns, are pooled;
 - the income or returns or the arrangement are generated from the acquisition, holding, management or disposal or any property or assets or business activities;
 - the person expects a return in any form from the trading, conversion or redemption of the digital token or the appreciation in the value of the digital token;
 - the person does not have day-to-day control over the management of the property, assets or business of the arrangement; **and**
 - the digital token is not issued or guaranteed by any government body or central banks as may be specified by Securities Commission.

● Securities Commission Guidelines on Digital Assets

Provides for:

- **Requirements on the issuance of a digital token offering.**
 - ✓ issuer must have minimum paid up capital of RM500,000; minimum 2 Malaysian resident directors;
 - ✓ Directors and senior management must own at least 50% equity in the issuer on the date of the issue of tokens;
 - ✓ Post token issue, initial and new directors/senior management may sell not more than half of their initial or purchased equity until completion of the token's project;
 - ✓ Must carry out offering of tokens through an IEO platform and no other means;
 - ✓ Must demonstrate to IEO operator that the token's underlying business/project provides an innovative solution or meaningful digital value proposition for Malaysia;
 - ✓ Must be accompanied by a White Paper;
 - ✓ Must publish on the IEO platform an annual report and semi-annual report containing information on the total amount of tokens issued and in circulation, status of the utilisation of the token's proceeds by the issuer, status of the project and audited financial statements for the latest financial year.

● Securities Commission Guidelines on Digital Assets

- **Requirements on the registration of a platform operator to operate an Initial Exchange Offering (IEO).**
 - ✓ Any person who wish to operate an IEO platform must be registered under these Guidelines, and if the person also wish to facilitate the trading of digital assets, must also be registered as a DAX operator;
 - ✓ IEO operator must be minimum paid capital of RM5,000,000; qualified responsible person;
 - ✓ Obligations prior to approving a digital token offering; risk assessment;
 - ✓ Limit of Funds raised by Issuer:
 - Issuer may only raise funds of a maximum multiple of 20 of the issuer's shareholders fund within any continuous 12-month period, subject to a ceiling of RM100 million;
 - must be fully subscribed, with no permitted over-subscription of tokens, to be effective;
 - ✓ Investment limits – a person may invest in digital token offerings subject to the following limits:
 - for sophisticated investors, no restriction on investment amounts;
 - For angel investors, a maximum of RM500,000 within a 12-month period;
 - For retail investors, a maximum of RM2,000 per issuer with a total investment limit not exceeding RM20,000 within a 12-month period.

● Securities Commission Guidelines on Recognised Markets

- Requirements on the registration of a person as a **recognised market operator (RMO)**.
- **Recognised market** includes the equity crowdfunding platform (ECF), peer-to-peer (P2P) financing platform, **digital asset exchange (DAX)**, property crowdfunding (PCF) platform and e-services platform.
- Sets out obligations of RMOs – directors and responsible persons, outsourcing, compliance.
- Chapter specifically enabling DAX introduced in January 2019 following SC's recognition of digital currencies and tokens via the 15 Jan 2019 Prescription Order.
- DAX - an electronic platform which facilitates the trading of a Digital Asset (Digital Currency or Digital Token).
- Eligibility and financial requirements on DAX Operators:
 - ✓ Incorporated in Malaysia, minimum paid up capital of RM5 million;
 - ✓ Need 1 independent director if DAX operator is a public company;
 - ✓ Prohibited from providing financial assistance to investors (including its officers and employees) to invest or trade in digital assets on its platform;
 - ✓ Can facilitate trading of Digital Assets only with SC's approval;
 - ✓ Asset protection – investors' monies must be held in trust accounts in a licensed Malaysian financial institution and administered by an independent registered trustee, establish and maintain secured storage medium designated to store Digital Assets.
 - ✓ Transparency – trading information is made publicly available on real-time basis.

● Labuan Financial Services and Securities Act 2010

Digital financial service providers are able to operate within framework of existing laws and regulations.

- Labuan Financial Services and Securities Act 2010 and related guidelines and approvals;
- Circular on Innovative Financial Services (IFS) in Labuan (2018).
 - ✓ no specific guidelines yet;
 - ✓ Labuan FSA supports the offer of IFS through Labuan IBFC – **digital currency** activities, **robo-advisory** activities, **blockchains or distributed ledger**, **insurTech**;
 - ✓ maintain necessary cyber resilience;
 - ✓ Comply with BNM AMLA Guidelines (Digital Currencies – Sector 6)
- Comply with new tax substance requirements as a Labuan licensed entity.

● Labuan Financial Services and Securities Act 2010

Money broking licence

Business of arranging transactions between buyers and sellers in the money or foreign exchange markets as an intermediary in consideration of brokerage fees paid or to be paid.

Credit token licence

Business by a person (“issuer”) where a token, being a cheque, card, voucher, stamps, booklet, coupon, form or other document or thing is given or issued to a person (“customer”), where the issuer undertakes (a) that on the production of the token, the issuer will supply cash, goods or services on credit; or (b) that where, on the production of the token to a third party, the third party supplies cash, goods or services, the issuer will pay the third party for them, whether or not deducting any discount or commission, in return for payment to be made thereafter to the issuer by the customer.

Securities licence

Business by a person, who for valuable consideration, provides investment advice or administrative services in respect of securities for the purpose of investment, including dealing in securities or such other activity as may be specified by the Authority.

Payment systems approval

Any system or arrangement for the transfer, clearing or settlement of funds or securities. Approval under section 171 to operate any payment system in, from or through Labuan.

Approved exchange

Includes a body corporate established as a securities exchange under section 134 of the Act.

● Labuan Financial Services and Securities Act 2010

- Guidelines on Money Broking Business in Labuan.
 - ✓ Applicant must be individual or institution with money broking expertise, or is a regulated money broker from other jurisdictions, or is a licensed institution under the Malaysian Financial Services Act 2013.
 - ✓ Maintain paid up capital of RM500,000 or foreign currency equivalent;
 - ✓ Maintain operational office in Labuan; directors and principal officer are fit and proper persons;
 - ✓ Appoint Labuan approved auditor.
 - ✓ Where model/customer interface is electronic, must have proper management of technology risk.
- Approved Exchange under Part IX of the Labuan Financial Services and Securities Act 2010.
 - ✓ Have adequate internal policies and procedures for its operations, compliances, internal controls, corporate governance and risk management, including business continuity plan;
 - ✓ Have own set of by-laws and Rules of Exchange;
 - ✓ Need prior approval from LFSA on appointment of shareholders, committee members, directors and principal officer.

● AML Requirements

Anti-Money Laundering and Counter Financing of Terrorism – Digital Currencies (Sector 6). Persons are reporting institutions if they carry on activities which provides any or any combination of the following services:

- Exchanging digital currency for money;
- Exchanging money for digital currency; or
- Exchanging one digital currency for another digital currency,

Whether in the course of carrying on a digital currency exchange or otherwise.

- ✓ Requirements on Customer Due Diligence; Management Information System; Record-keeping; Suspicious Transaction Report;
- ✓ **Identify and assess** ML/TF risks on development of new digital currencies, products, services and business practices, including new delivery mechanisms, and use of new or developing technologies whether for new or existing solutions.
- ✓ **Publish** the prices of digital currencies exchanged, including the pricing methodology used in determining the prices for the exchange of digital currencies.

Labuan FAQs on Innovative Financial Services – Labuan entities that undertake IFS activities, particularly on the exchange of digital currencies either from or to fiat money, or from or to another digital currency, need to comply with AML requirements above as reporting institutions.

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Is There a Need for Regulation?

Jonathan Lim

Partner, Zaid Ibrahim & Co Malaysia

28 July 2020

The logo for ASEAN INSIDERS features a large, stylized graphic of a human head profile on the right side of the slide, composed of a dense grid of small, light blue dots. A single yellow dot is positioned at the bottom of the head's neck area. To the left of this graphic, the text "ASEAN INSIDERS" is written in a bold, white, sans-serif font, with "by origin and passion" in a smaller, white, sans-serif font below it.

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IS THERE A REAL NEED FOR REGULATION?

Recognition of Crypto Assets and Crypto Exchanges

Jurisdiction	Crypto Currency	Crypto Exchange
United States	Not legal tender	Legal, regulation varies by state
South Korea	Not legal tender	Legal, must register with FSS
Canada	Not legal tender	Legal, register with FinTRAC after June 1, 2020
Singapore	Not legal tender	Legal, registration with the MAS required
Australia	Legal, treated as property	Legal, must register with AUSTRAC
Japan	Legal, treated as property	Legal, must register with the FSA
The EU	Legal, member-states may not introduce their own cryptocurrencies	Regulations vary by member-state
Gibraltar	Not legal tender	Legal, must register with the GFSC
Luxembourg	Not legal tender	Legal, must register with the CSSF
China	Not legal tender	Illegal
India	Not legal tender	Effectively illegal – regulations being considered
UK	Not legal tender	Legal, registration requirements with FCA
Switzerland	Legal, accepted as payment in some contexts	Legal, regulated by SFTA
Malta	Not legal tender	Legal, regulated under the VFA Act
Estonia	Not legal tender	Legal, must register with the Financial Intelligence Unit
Latin America	Laws vary by country	Sparse regulation, laws vary by country

● Financial Action Task Force

Virtual Assets and Virtual Service Providers (VASP)

“**Tokenization**” is the process of digitally representing an asset, or ownership of an asset. A token represents an asset or ownership of an asset. Such assets can be currencies, commodities or securities or properties.

“**Virtual asset**” is a digital representation of value that can be digitally traded, or transferred, and can be used for payment or investment purposes. Virtual assets do not include digital representations of fiat currencies, securities and other financial assets that are already covered elsewhere in the FATF Recommendations.

“**Virtual Asset Service Provider**” means any natural or legal person who is not covered elsewhere under the Recommendations, and as a business conducts one or more of the following activities or operations for or on behalf of another natural or legal person:

- i. exchange between virtual assets and fiat currencies;
- ii. exchange between one or more forms of virtual assets;
- iii. transfer of virtual assets;
- iv. safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets; and
- v. participation in and provision of financial services related to an issuer’s offer and/or sale of a virtual asset.

● Issues Risk and Regulatory

The G20 Ministers of Finance and Central Bank Governors acknowledged in the Communiqué following their March 2018 meeting in Buenos Aires that **crypto-assets are not a material risk to financial stability, but** “raised issues with respect to **consumer and investor protection, market integrity, tax evasion, money laundering and terrorist financing.**”

The main trends in the virtual asset ML/TF risk landscape since June 2019 include:

- a) the use of VASPs registered or operating in jurisdictions that lack effective AML/CFT regulation, as well as the use of multiple VASPs (local and/or overseas). This makes it more challenging for competent authorities to follow the transaction trail, buying more time for criminals to move criminal proceeds.
- b) the continued use of tools and methods to increase the anonymity of transactions.

This includes registering Internet domain names through proxies and using DNS registrars that suppress or redact the true owners of the domain names, the use of tumblers, mixers and anonymity-enhanced cryptocurrencies or privacy coins, using decentralised exchanges and applications, chain-hopping and atomic swapping exchanges (which allow the exchange of one type of virtual asset to another without going through an exchange) and dusting (which allows the transfer of tiny amounts of virtual assets to random wallets, making it more difficult to track and trace the transaction trail).

● Issues Risk and Regulatory

Peer-to-peer transactions and private / non-custodial wallets.

Peer-to-peer transfers of virtual assets, without the use or involvement of a VASP or financial institution, are not explicitly subject to AML/CFT obligations under the revised FATF Standards. The lack of explicit coverage of peer to-peer virtual asset transactions of this type was deliberate, as the revised FATF Standards' general focus is on placing AML/CFT obligations on intermediaries between individuals and the financial system. The lack of explicit coverage of peer-to-peer transactions via private / unhosted wallets was a source of concern for a number of jurisdictions. Jurisdictions noted that transfers to the unregulated peer-to-peer sector could present a leak in tracing illicit flows of virtual assets.

So-called stablecoins

The emergence of proposals for so-called stablecoins. Some proposals for so-called stablecoins have the potential to be mass-adopted on a scale not seen in pre-existing virtual assets. Depending on their design and national laws, they may be a virtual asset or traditional financial asset under the revised FATF Standards. As set out in the FATF's report to the G20, the revised FATF Standards apply to so-called stablecoins and their providers either as financial institutions or VASPs.

● Issues Risk and Regulatory

Travel rule implementation.

A range of identified issues remain which impact the full, effective and smooth implementation of a global framework for the travel rule.

In order to comply with the travel rule, VASPs must be able to identify when they are :

- (a) transacting with another VASP (as opposed to a private wallet) and
- (b) whether the counterparty VASP is registered / licenced by a jurisdiction and adequately supervised for AML/CFT purposes. The best way to conduct counterparty due diligence in a timely and secure manner is a challenge.

One way to address this issue which has been raised by the private sector is the creation of a 'global list of VASPs'. In this approach, information on licensed and registered VASPs would be collected from each jurisdiction's list and accessed through a central database (in a centralised approach) or accessed through an API / smart contracts which connect to each jurisdiction's list (in a decentralised approach).

The 'travel rule' is a key AML/CFT measure, which mandates that VASPs obtain, hold and exchange information about the originators and beneficiaries of virtual asset transfers.

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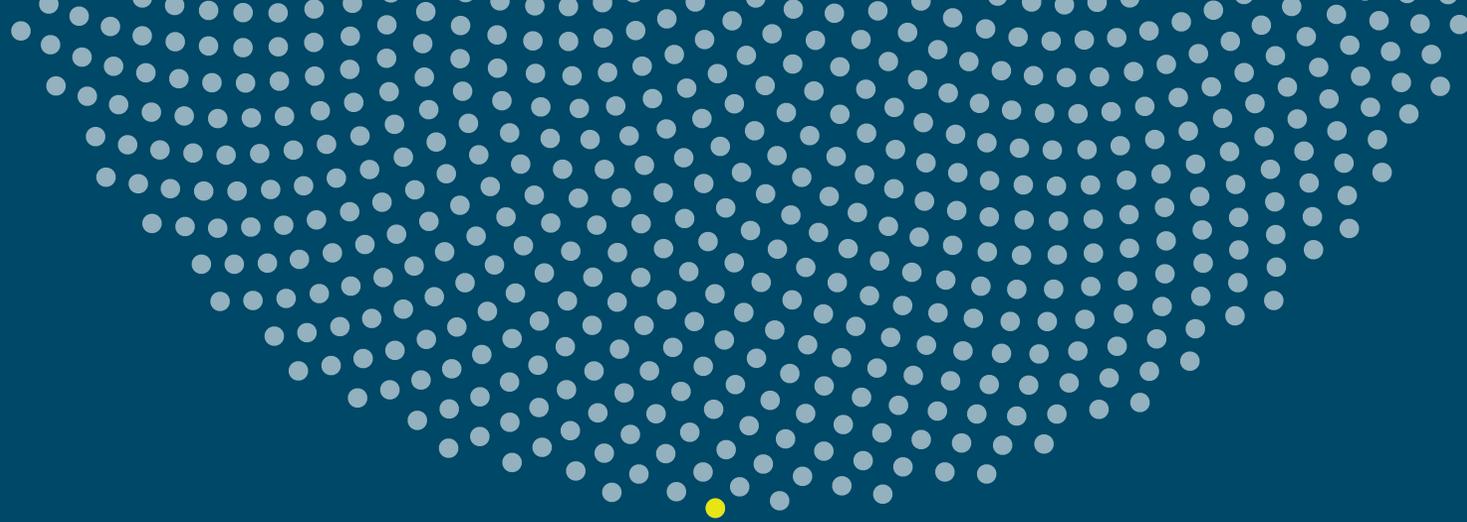
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Poll Questions & Results

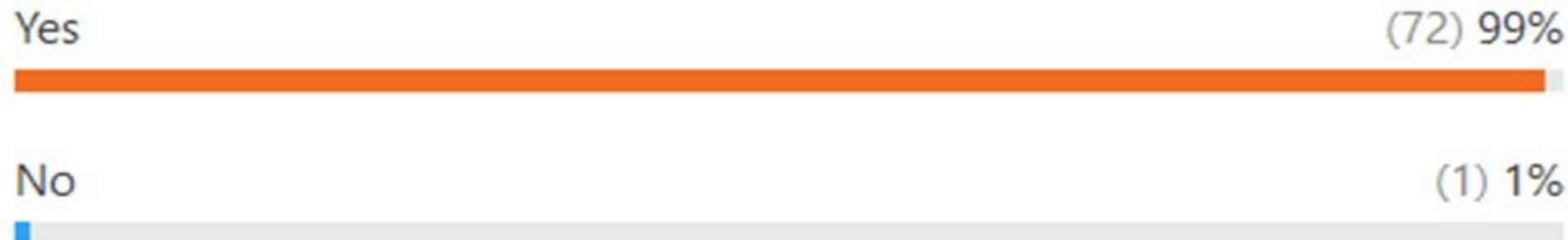


Polling 1: Regulatory Recognition for the Dig... ▼

Polling is closed

73 voted

1. Do you think the digital community needs regulatory recognition?



Polling 2: Timing



Polling is closed

86 voted

1. Do you think the time is right to have further specific guidelines for the digital market in Labuan IBFC, in order to better maneuver its licensing opportunities?



Polling 3: Techfin Replace Fintech



Polling is closed

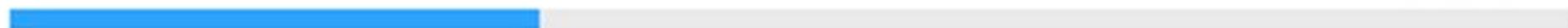
70 voted

1. Will developments in financial services eventually be determined by technology? So, do you think techfin replaces fintech?

Yes (46) 66%



No (24) 34%





THANK YOU

